

Parliament of the Commonwealth of Australia

**SENATE ECONOMICS LEGISLATION
COMMITTEE**

**CONSIDERATION OF LEGISLATION
REFERRED TO THE COMMITTEE**

**Excise Tariff Amendment Bill (No.1) 2000
Customs Tariff Amendment Bill (No.1) 2000**

May 2000

Commonwealth of Australia

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Senate Economics Legislation Committee

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REPORT

Reference of the Bills to the Committee

1.1 Excise Tariff Amendment Bill (No.1) 2000 and Customs Tariff Amendment Bill (No.1) 2000 were introduced into the House of Representatives on 17 February 2000. Following a report by the Selection of Bills Committee, the Senate referred the Bill to this Committee on 8 March 2000 for examination and report by 4 April 2000.¹ An extension was granted by the Senate to allow the Committee to report by 9 May 2000.

The Committee's Inquiry

1.2 The Committee invited a number of interested parties to make submissions on the bills, in addition to advertising the inquiry. The Committee received seven submissions to the inquiry (see Appendix 1).

1.3 The Committee held a public hearing on the bills in Canberra on 8 May 2000. The witnesses who appeared at the hearing are shown in Appendix 2.

The Bills

1.4 Both bills ratify two major changes to the tariff on tobacco and petroleum products that came into effect in late 1999, namely:

- the substitution of a 'per stick' rate of tariff on lightweight tobacco products to discourage smoking of high volume, lightweight cigarettes (1 November 1999); and
- the altering of the tariff on certain petroleum products to combat the substitution of these products for higher-excite fuel (15 November 1999).

1.5 The inclusion of the same measures in two separate bills reflects the division of labour for revenue collection between the Australian Taxation Office (ATO) and the Australian Customs Service (Customs). Following changes in excise collection arrangements in 1999, the ATO now collects excise on *domestic* products, while ACS remains responsible for collecting duty on *imported* goods. Of the two agencies, the ATO has overall responsibility for fuel substitution matters.

1.6 The Selection of Bills Committee requested that this Committee examine and report on the measures dealing solely with fuel substitution.

1.7 In particular, the Committee was asked to examine how effective measures contained in these bills have been in stopping fuel substitution activities that are reported to have led to a significant loss of revenue to the Commonwealth as well as damage to many motor vehicles through the dilution of fuel with high concentrations of tax-free solvents.

1 Selection of Bills Committee Report No. 2 of 2000, dated 8 March 2000.

Background to the Bills

1.8 The bills need to be seen in their historical context, as well as in light of recent fuel substitution activities that occurred after the tariff restructure came into force. The background to the bills is described here; the recent case of toluene substitution is discussed at paragraphs 1.26-1.28.

1.9 Excise on petroleum products has historically been levied at differential rates depending on the intended end use of the product. Fuels for on-road use (eg, diesel and unleaded petrol) attracted a higher tariff, while the tariff on non-transport fuels (eg, heating oils and kerosene) was at a lower rate. Other products with a non-fuel use (eg, solvents) were duty free.²

1.10 The differential tariff structure has been open to exploitation to avoid paying excise duty. For example, transport fuels have been blended with lower excise non-transport products to reduce the overall tariff. The cost of this excise evasion and avoidance has been not only in terms of reduced revenue but also damage to vehicle engines, unfair competition and distortion of the market.

1.11 The bills are intended to supplement earlier legislation designed to deter and detect these fuel substitution activities. Legislative changes in January 1998 required a chemical marker to be added to fuels attracting the concessional rate. The use of the marker was to enhance detection in instances where non-transport fuels were blended with or substituted for higher excise transport fuel.

1.12 However, this method of enforcement proved to be less than successful,³ leading to the more systemic measures that the two bills ratify. In addition, technical problems with the marker system are to be rectified under the *Petroleum Excise Amendment (Measures to Address Evasion) Bill 2000*, which was introduced into the House of Representatives on 6 April 2000.⁴

Changes under the bills – fuel substitution measures

1.13 The bills introduce a new tariff structure. In particular, the excise-free status of certain petrol and diesel products used to evade the full excise has been removed. All petrol and diesel (other than recycled products) are subject to the same rate of excise as that which applies for fuel used by motor vehicles.

1.14 The bills state that alternative arrangements have been made to compensate those with a legitimate need to use these products for non-fuel purposes. These arrangements also double as strengthened compliance measures, limiting the amount of concessional fuel available in the market and therefore the potential for fuel substitution.⁵

2 Bills Digest No. 123 1999-2000, Excise Tariff Amendment Bill (No.1) 2000, p. 3.

3 See ATO Media Release – Nat 2000/6, 3 March 2000.

4 ATO, Submission No. 6, p. 3.

5 ATO, Submission No. 6, p. 3.

1.15 The bills also add heating oil in containers of less than 210 litres to the list of products which must contain a chemical marker, as well as clarifying the tariff list for recycled petroleum products.

Comparison of key features of new and previous law⁶

<i>New law</i>	<i>Previous law</i>
Excise is payable on all diesel and gasoline (other than recycled product, recovered by a process other than refining) at the rate which applies for fuel used in an internal combustion engine. The excise rate differential between leaded and unleaded gasoline is retained.	Where diesel and gasoline were not for use as a fuel, they were available duty free. The products could either be drummed (ie in packages not exceeding 210 litres) or in bulk with the chemical marker added.
Alternative arrangements are in place to protect those with a legitimate need to access product for use other than as fuel.	Diesel and gasoline were also available at a lesser rate of duty if they were for use as a fuel, but not in an internal combustion engine.
Heating oil still available duty free but must contain a chemical marker to show it is for fuel use other than in an internal combustion engine or for use other than as a fuel (eg as a solvent).	Heating oil was available duty free and without a chemical marker if drummed (ie in packages not exceeding 210 litres).
The list of goods covered by item 11 has been amended to more clearly set out that it includes certain recycled petroleum products.	Did not clearly include certain recycled petroleum products.

Issues in Evidence

1.16 Industry submissions shared the same criticism that the measures contained in the bills do not go far enough to combat fuel substitution. The Australian Automobile Association, for instance, described the measures as an “incomplete solution” to the problem.⁷

1.17 While the tariff restructure and associated measures were in themselves viewed as useful, the consensus was that more is required if illicit blending is to be eliminated. Several organisations pointed to particular faults in the existing anti-substitution regime and recommended specific reforms, while others argued that a more fundamental overhaul of the tariff structure is necessary. Some of the key proposals included:

- stronger coordination at the Commonwealth-State level;⁸

6 Excise Tariff Amendment Bill (No.1) 2000, Explanatory Memorandum, p. 10.

7 Submission No. 1, p. 1.

8 NRMA, Submission No. 2, p. 1.

- consolidation into a single agency of the responsibilities currently shared between the ATO and Customs;⁹
- “more visible and continuous random sampling” to both detect and deter substitution;¹⁰
- updating and strengthening the Australian standard for petrol, in particular giving it legislative backing;¹¹ and
- replacing the differentiated tariff structure with a uniform structure, augmented with an expanded rebate system.¹²

Responsibility for fuel quality

1.18 Not all of the above recommendations fall under the scope of the bills. This point reflects how some submissions appear to have confused the division of responsibilities between the relevant Commonwealth agencies (the ATO and ACS) and State governments on petrol regulation. The Commonwealth’s role in relation to petroleum excise is to protect the revenue; consumer protection for matters such as fuel quality is the responsibility of State administrations. According to the ATO:

Although the excise system is not directly involved in assuring fuel quality, certain excise evasion practices such as fuel substitution can have an effect on the quality of some products. Consumer protection matters are primarily the responsibility of the States and Territories under fair trading laws. While the ATO is interested in receipt of information concerning demonstrated excise evasion from all sources, including the States, it does not have explicit arrangements in place with State agencies given the differing roles of the respective agencies.¹³

1.19 Similarly, the role of Customs is limited to revenue collection of customs duty on imported goods and does not extend beyond the border to enforcement of end use or arrangements with State agencies in relation to fuel substitution or fuel quality.¹⁴

1.20 Consequently, some recommendations calling for the Commonwealth to play a more assertive role with State and Territory administrations, or to police fuel quality more vigorously, were misdirected. Such recommendations referred to matters outside the ambit of both the bills and the responsibilities of the ATO and ACS. Similarly, the recommendation for a more stringent Australian petrol standard falls outside the context of the two bills.

1.21 Nonetheless, the ATO noted that work on these matters is being done at the Commonwealth level by other bodies. The Minister for Industry, Science and Resources issued the “Downstream Petroleum Products Action Agenda” in late 1999.¹⁵ As well,

9 Australian Institute of Petroleum, Submission No. 3, p. 2.

10 Submission No. 2, p. 2.

11 Submission No. 1, p. 1 and Submission No. 2, i.

12 Submission No. 3 and Liberty Oil Pty Ltd, Submission No. 5.

13 Submission No. 6, p. 1.

14 Submission No. 7, pp. 1-2.

15 Submission No. 6, p. 2.

Environment Australia is coordinating work on fuel quality standards which has involved consultations with Customs. Customs has indicated that controls can be established to help ensure that imported products meet any future standards.¹⁶

1.22 The Committee considers that groups and organisations with information and recommendations about fuel standards should address their concerns to the relevant Commonwealth agencies, the Department of Industry, Science and Resources and Environment Australia.

The compliance risk – a “moving target”

1.23 A common thread in the evidence of the Government and industry is the ease with which excise evaders have been able to shift to new products for substitution in response to government counter-measures. One industry company described the compliance risk as a “moving target ... once one loophole is closed, the perpetration of the fuel substitution rackets moves onto other products”.¹⁷ The ATO confirmed this view, saying that this pattern of circumvention has been a “common experience”.¹⁸

1.24 Where the Government and industry differ, however, is over the main cause of the problem. The ATO and Customs attributed the problem primarily to the nature of many petroleum products which can be easily substituted or blended with higher duty fuel.¹⁹ Customs also stated that the “principal risk” with imported products is intentional misdescription to avoid paying the prescribed duty.²⁰

1.25 In the eyes of some in the industry, however, it is the differential tariff that creates the incentive to substitute or blend concessional fuel in order to evade paying the full duty. This inherent flaw with the tariff system is, the industry contended, compounded by the Government’s case by case approach to the problem which has failed to eliminate loopholes for evasion.²¹ The recent case of imported toluene substitution demonstrates the ability of excise evaders to exploit loopholes in the system.

Recent fuel substitution – imported toluene

1.26 Despite the new measures in the bills coming into effect in November 1999, concerns about fuel substitution re-emerged earlier this year when imported toluene was discovered blended in fuel sold for motor vehicle use. At the time, toluene was duty free if imported, but subject to excise if produced locally.

1.27 The Commissioner of Taxation, Mr Michael Carmody, pointed to a link between the effectiveness of the measures that the bills ratify and the illicit blending of toluene. Mr Carmody claimed that the new tariff structure had “immediately closed off the excise

16 Submission No. 6, p. 2 and Submission No. 7, p. 2.

17 Liberty Oil Pty Ltd, Submission No. 5, p. 1.

18 Submission No. 6, p. 4.

19 ATO, Submission No. 6, p. 2 and pp. 4-5, which detail the products and avenues open to substitution and blending.

20 Submission No. 7, p. 2.

21 AIP Submission No. 3, RACV, Submission No. 4 and Liberty Oil Pty Ltd, Submission No. 5.

evasion practices then in place” (ie, late-1999), including the blending of domestically produced solvents. The effectiveness of the new tariff had, in the Commissioner’s view, forced unscrupulous operators to resort to other products such as imported toluene:

The practice of importing toluene for fuel substitution appears to have arisen in response to our action to close off previous evasion practices.²²

1.28 Customs stated, however, that the substitution of toluene also arose due to the discrepancy between the excise and customs tariffs on imported and locally produced toluene.²³ This inconsistency suggests a possible lack of coordination between the responsible agencies, Customs and ATO, a point which was part of the general criticism of the approach at the Commonwealth and State level to fuel substitution problems.²⁴ But according to Customs: “Inconsistencies of this type [over toluene] are rare and consultation between the two agencies should prevent a recurrence”.²⁵

1.29 Nonetheless, Committee members raised the wider issue of the adequacy of coordination among government agencies, including but not limited to the ATO and Customs.²⁶ Information sharing and the exchange of intelligence among relevant government bodies are crucial for early warning and detection of evasion schemes such as that involving imported toluene. There may be scope for bodies such as the National Industrial Chemicals Notification and Assessment Scheme, which provides information and recommendations to other government bodies with regulation responsibilities for industrial chemicals to assist the ATO and Customs in detecting and controlling fuel substitution activities.

Tariff Proposal

1.30 To address the toluene problem, the Government tabled a tariff proposal on 9 March 2000 which came into effect the following day. Although not part of the Committee’s consideration of the bills, the tariff proposal should be noted as it complements measures in the bills by making further adjustment to the tariff structure. The proposal imposes an excise equivalent duty on all imported toluene. To pre-empt dishonest operators from switching to other duty free products, the proposal also covers imported benzene, xylenes and mixed alkylbenzenes.²⁷

1.31 Although the tariff proposal was supported by industry groups, concern remains that, like the bills, it does not go far enough in closing off all loopholes and avenues for exploitation by excise evaders.²⁸ Industry groups predict that the tariff proposal will simply prompt the evaders to switch to different products and continue the “moving target” problem. Indeed, one company alleged that this has already happened, claiming that a

22 ‘Claims of inaction on excise evasion and fuel substitution simply untrue’, ATO Media Release – Nat 2000/6, 3 March 2000.

23 Submission No. 7, p. 2.

24 Submission No. 2, p.1 and Submission No. 4, p. 1.

25 Submission No. 7, p. 2.

26 Evidence, pp. 6, 9-10.

27 See *Hansard*, House of Representatives, 9 March 2000, pp. 14022-23.

28 NRMA, Submission No. 2, p. 3.

substitution operation involving the blending of the product Naptha with unleaded petrol is currently active.²⁹

The uniform tariff proposal

1.32 The Australian Institute of Petroleum (AIP) argued that replacing the differential tariff with a uniform tariff is the key to removing the incentive for fuel substitution. The AIP and others³⁰ claimed that unless the same tariff covers all products, rogue operators would continue to switch to other duty free or lower excise products as the Government closes off other avenues for evasion.³¹

1.33 The AIP's uniform tariff proposal includes a system of rebates for legitimate users of non-transport fuels. (A copy of the uniform tariff proposal is at Appendix 3.) According to the AIP:

The advantage to the Government of a rebate system is clear: the Government would receive excise proceeds up-front and those applying for rebates would have to demonstrate that the intended use of the product was legitimate.³²

1.34 The AIP also argued that a rebate system would be more effective and economical than current measures, such as the use of chemical markers. The Commissioner of Taxation has also stated that chemical markers and fuel testing have not proven entirely effective.³³

1.35 The AIP wrote to the Assistant Treasurer in late March outlining its proposal for excise uniformity. A sub-committee of the Petroleum Liaison Committee, a consultative body that combines Commonwealth agencies and industry stakeholders, is currently considering the proposal.

1.36 Both the ATO and Customs gave qualified support for the uniform tariff proposal. While the measure would eliminate substitution problems associated with heating fuels, it is not a complete solution. Other compliance risks would remain, although these appear to be manageable. According to the ATO:

Should the above [uniform tariff] option be put in place, the principal remaining compliance problems on the taxing side would be illicit production (which is limited by its nature) and misdescription of imported goods, both of which can be addressed by a redirection of licensing and compliance effort. There would of course be compliance issues on the transfer side with rebate/refund/grant schemes, but there are advantages in that risks can be positively identified and where fraud does occur, offences easier to prove.³⁴

1.37 Customs predicted that the proposal would increase compliance costs for importers. Legitimate non-fuel users were also expected to oppose measures that introduced up-front

29 Liberty Oil Pty Ltd, Submission No. 5, p. 1.

30 Liberty Oil Pty Ltd, Submission No. 5, endorsed the AIP proposal for a uniform tariff regime.

31 AIP Submission No. 3, Attachment 3.

32 Submission No. 3, Attachment 3, p. 2.

33 ATO Media Release – Nat 2000/6, 3 March 2000.

34 Submission No. 6, p. 5.

costs under a revised rebate scheme.³⁵ The subcommittee examining the proposal is currently endeavouring to get a clearer picture of the proposal's likely impact on legitimate users. For example, the significant number of private consumers who are believed to rely on heating fuel and kerosene is one group that could be significantly disadvantaged under the proposed rebate system. However, the subcommittee is still in the process of collecting information on these consumers, which is one of the reasons for the delay in concluding consideration of the proposal.³⁶

1.38 The Committee considers the uniform tariff proposal to have merit, particularly if it can be demonstrated that it will eliminate the type of loopholes exploited by excise evaders in the past. Any consideration of the scheme's overall worth will, nonetheless, need to weigh its benefits, in terms of protecting the revenue and fuel quality from substitution practices, against the costs likely to be imposed on legitimate users.

1.39 However, officers from the ATO and Customs told the Committee at its hearing on the bills that a comprehensive solution along the lines of the uniform tariff proposal is some way off. In the absence of such a solution, these officers stated that the passing of the bills by the Senate is "critical", noting that a failure to do so could "open the floodgates" for fuel substitution and excise evasion.³⁷

1.40 The Committee considers that the measures contained in the bills are important for countering fuel substitution activities. While other options remain under consideration, the passage of the bills through the Senate should not be delayed.

Recommendation

1.41 The Committee recommends that the Senate pass the Bills.

Senator the Hon Brian Gibson
Chairman

35 Submission No. 7, p. 3.

36 Evidence, p. 14.

37 Evidence, p. 18.

LABOR SENATORS' MINORITY REPORT

Labor supports these Bills. We regard the problem of fuel substitutions as an issue of the utmost importance to the Australian Community. Labor Senators are very concerned at the Government's handling of the transition between the Australian Customs Service and the Australian Tax Office of responsibility for detecting and action on petrol substitution fraud. Evidence provided before the Committee clearly shows that the two agencies have an entirely different perspective on their roles.

This is at odds with the claims of the Government which when introducing the original package of bills to combat fuel substitution into the Parliament in 1997, said that it had two aims, to protect revenue and protect consumers.

It seems that the Australian Customs Service had placed some emphasis on monitoring and exposure of cases of substitution. The evidence shows that this has been given a very low priority by the ATO. It is of great concern that the ATO are placing primary emphasis on the current legislative changes in order to resolve the problem and only a minor emphasis on investigation and prosecution of fuel substitution. This may well be due to the ATO being preoccupied by the introduction of the GST and A New Tax System.

Labor Senators note that operators such as Liberty Oil Pty Ltd and APCO Service Stations Pty Ltd have made many representations to the government on the subject of fuel substitution. These representations can be identified back to May 1999 but the government has taken little action to investigate these allegations and prosecute offenders. To date, only one successful prosecution has occurred. It is only when allegations receive national attention that they are seriously investigated.

The level of communication between the relevant Ministers and the ATO and Customs Service shows a clear lack of interest in the issue and in particular a total lack of interest when it comes to protecting consumers from the dangerous practice of fuel substitution. We await answers from the Tax office as to what advice they received from the Treasurer, Assistant Treasurer, Customs Minister and Attorney General, who were all lobbied concerning this problem long before any action was taken.

We also note that complete answers on the issue of the trucks purchased by Customs and transferred to the ATO for field-testing are yet to be given to the committee. The possible sale of these trucks is of great concern to the Labor Senators as they represent the front line of testing.

SENATOR CAMPBELL SENATOR MURPHY

APPENDIX 1**LIST OF SUBMISSIONS**

- No.1 Australian Automotive Association
- No.2 NRMA
- No.3 Australian Institute of Petroleum
- No.4 Royal Automobile Club of Victoria (RACV)
- No.5 Liberty Oil Pty Ltd
- No.5A Liberty Oil Pty Ltd (Confidential)
- No.6 Australian Taxation Office
- No.7 Australian Customs Service

APPENDIX 2**LIST OF WITNESSES
APPEARING BEFORE THE COMMITTEE**

Monday, 8 May 2000

Committee Room 1S3, Parliament House, Canberra

Liberty Oil Pty Ltd

Mr Mark Kevin, Chief Executive Officer

Australian Customs Service

Mr Phil Burns, Director, Commercial

Mr Dan Dawes, Director, Compliance Operations

Mr Ray Banvill, Senior Inspector, Tariff Legislation

Australian Taxation Office

Mr Mark Jackson, Deputy Commissioner, Excise

Mr Tony Free, National Director, Excise Revenue Policy

Mr John Charleston, National Director, Petroleum Excise Business Group

APPENDIX 3

AUSTRALIAN INSTITUTE OF PETROLEUM

EXCISE UNIFORMITY PROPOSAL

Introduction

Fuel substitution occurs because unscrupulous operators profit dishonestly from blending low or zero excise petroleum products with products subject to excise at the transport rate.

The most recent example of this activity has been the revelation that tax-free solvents, such as toluene, have been blended with petrol and sold to unsuspecting motorists.

The Australian Institute of Petroleum and its member companies condemn these activities and welcome the Commonwealth initiative aimed at preventing these activities occurring. However AIP believes significant scope remains for fuel substitution activities to simply move to petroleum products not covered by the recent announcement.

At present, holders of remission certificates or exemptions are able to purchase petroleum products at the concessional excise rates. This system cannot be easily controlled, which in turn provides the basis on which the fuel substitution activities are occurring.

The most effective way to prevent low and high excise products being blended is to remove the incentive to do so, by eliminating the differential in excise rates. AIP therefore proposes that all relevant petroleum products be subject to uniform excise rates, with rebates to genuine users to ensure they are not disadvantaged.

Simplification of Customs and Excise rates

AIP's recommendations relate to the various products under the current excise tariff item 11, which contains ten sub-items. Many of these sub-items are further divided, giving rise to a total of 56 separate excise classifications under which goods are entered. However only five different rates of duty apply.

The suggested changes are for item 11 goods to be placed in 3 groups, as outlined below.

Group 1 – Aviation Fuels

The current duty rate for aviation fuels is not designed as a general revenue raising rate, but rather to meet Government requirements to fund certain aircraft safety operations. For the purposes of this paper, it is assumed that this will continue to be the Government's intent. Given this, AIP suggests that a single low rate replace the two different current low rates. Further, due to the possible diversion of aircraft fuel into non-aviation uses, we propose a two-rate structure as follows:

Sub item 1: Aviation fuels, purchased under an accreditation certificate, as described below (current duty rate \$0.01809 per litre).

Sub item 2: Aviation fuels (current duty rate \$0.44137 per litre)

Genuine users of aviation fuels would be issued with an accreditation certificate that would allow the purchase of the fuels at the low rate of \$0.01809 per litre. The certificate could have various conditions that could, for example require the certificate holder to pay the high duty rate of \$0.44137 per litre for any fuels not used in aircraft.

This model would ensure that Commonwealth revenue was protected without imposing unintentional costs on genuine users of aviation fuels.

Group 2 – Gasolines having a flash point of less than 23 degrees celsius

The current duty rates for gasolines include a rate differential between unleaded gasolines and leaded gasolines. For the purposes of AIP's proposed model, it is assumed that this will continue as Government policy. There would be two sub-items within this group, being:

Sub item 1: Unleaded petrol and diesel (current duty rate \$0.44137 per litre)

Sub item 2: Leaded petrol (current duty rate \$0.46381 per litre)

Group 3 – Other refined or partly refined liquid petroleum products including diesel

This broad category would include, for example, fuel oil, diesel fuel in its various forms, solvents and other partly refined petroleum products. The single duty rate for these products would be \$0.44137 per litre, with rebates where appropriate to ensure legitimate users of these fuels would be no worse off under the changes.

Elimination of the incentive to blend fuels

The effect of this model is to align petroleum product excise rates at the transport rate, thereby removing the incentive to blend low excise products into high (transport rate) excise products.

Protection for legitimate users

A system of rebates for genuine users of non-transport fuels could be introduced to ensure they would not be disadvantaged under this proposal.

A rebate system would establish a clear, auditable paper trail and would vastly reduce the prospect of fraud, as claimants would have to account for the product on which they are claiming an excise rebate.

Excise uniformity with a rebate system would protect the interests of legitimate users and consumers, in addition to safeguarding Commonwealth revenue foregone due to fuel substitution activities.